



1 gas operations. I am a former member of the Southeastern Electric Exchange  
2 Rate Section and the Rate Research Committee of the Edison Electric Institute.

3 **Q. WILL YOU BRIEFLY SUMMARIZE YOUR DUTIES FOR SOUTH**  
4 **CAROLINA ELECTRIC & GAS COMPANY (SCE&G)?**

5 **A.** I am responsible for the design and administration of SCE&G's electric and gas  
6 rates and tariffs, including electric fuel adjustment, gas cost adjustment clauses,  
7 and rate administration.

8 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

9 **A.** The purpose of my testimony is to rebut certain portions of the testimony of Staff  
10 witness Jacqueline R. Cherry, specifically adjustments which she discusses at  
11 pages 6-7 of her prefiled testimony and in Audit Exhibit G. Carl Klein, in his  
12 rebuttal testimony, discusses substantive details regarding the issues raised by Ms.  
13 Cherry's analysis. In my testimony, I address the industry policy, practices, and  
14 regulatory provisions related to these issues.

15 **Q. PLEASE IDENTIFY THOSE PORTIONS OF HER ANALYSIS WITH**  
16 **WHICH YOU DISAGREE AND EXPLAIN WHY.**

17 **A.** In her testimony and in Audit Exhibit G, Ms. Cherry attempts to limit the  
18 recovery of costs for power purchased by SCE&G from Duke Power Company  
19 and Carolina Power and Light Company to the fuel component contained on  
20 invoices from those two companies. I believe that this is inconsistent with the  
21 language and intent of S.C. Code § 58-27-865(A) and the established, approved  
22 practices of this Commission and the industry generally. I base this opinion on  
23 30 years of experience in the industry related to the establishment of rates and

1 tariffs for the Company, specifically, my experience in dealing with the recovery  
2 of costs for purchased power. It is also based on my personal participation with  
3 other industry representatives in meetings with representatives of the South  
4 Carolina General Assembly, directly related to the objectives to be achieved by  
5 enactment of this statutory provision, and with the Staff of this Commission  
6 regarding the construction and implementation of this statutory provision.

7 **Q. PLEASE ELABORATE.**

8 **A.** Prior to 1983, FERC's regulations did not allow collection of fixed costs through  
9 the fuel adjustment clause. Purchased power capacity or other fixed charges,  
10 including wheeling, were only recoverable in base rates set in rate-case  
11 proceedings.

12 In 1983, FERC issued its Order No. 352 (Docket No. RM83-62-000) 18 C.F.R.  
13 Part 35 (December 7, 1983), which provides in pertinent part

14 The new rule allows electric utilities to recover all expenses  
15 associated with purchased power of less than 12 months duration  
16 through fuel clause adjustments if two conditions are met. First,  
17 the total cost of the purchase must be less than the buyer's total  
18 avoided variable cost. And second, the purpose of the purchase  
19 must be solely to displace higher cost generation. The second  
20 condition excludes from automatic recovery purchases made to  
21 maintain reserve levels or otherwise cure a capacity deficiency.  
22 The expenses that can be flowed through the fuel clause if both  
23 conditions are met include, but are not limited to, capacity or  
24 reservation charges, energy charges and any transmission or  
25 wheeling charges incurred in delivering the power to the buyer.

26  
27 (p. 30, 799). This order allowed the flow-through of fixed costs associated with  
28 the purchase of economic power, and, from 1983 forward, this was an accepted  
29 practice in the industry.

1   **Q.    DID FERC STATE THE OBJECTIVE OF ORDER 352 REGARDING THE**  
2       **RECOVERY OF THE COSTS ASSOCIATED WITH PURCHASED**  
3       **POWER?**

4   **A.    Yes. At 30,800-801, the Commission states:**

5           The present rule regarding the collection of purchased power  
6           expenses through fuel clause adjustments creates a potential  
7           distortion in a utility's purchasing decisions. The distortion arises  
8           if a utility does not accurately predict certain types of future  
9           economic purchase opportunities in a base rate case. A future  
10          purchase that carries capacity, reservation or wheeling charges  
11          could be cheaper than one that carries only energy charges. All of  
12          the energy charges incurred can be collected through the fuel  
13          clause under the existing rule but other non-fuel charges cannot. If  
14          those other charges are not contained in base rates, they will not be  
15          recovered. Two options are available under there conditions. One  
16          is to buy the more expensive energy. The buyer's stockholders are  
17          made whole and ratepayers are better off, but not as well off as  
18          they would have been had the cheaper purchase been made. The  
19          second option is to buy the cheaper power. Ratepayer benefits are  
20          maximized at the expense of stockholders because ratepayers get a  
21          subsidy from stockholders equal to the purchase charges not  
22          recovered through the fuel clause.

23  
24          Our primary purpose in adopting a new rule is to eliminate this  
25          potential distortion and encourage utilities to take the least-cost  
26          purchase opportunity. Our present fuel clause regulations were  
27          developed to allow the recovery of unpredictable fuel expenses.  
28          However, with economic purchases it is the opportunities that are  
29          unpredictable. The incidence of purchase forecasting risk is very  
30          different from that of predicting fuel costs. Without a fuel clause,  
31          unpredicted fuel cost increases would be an uncompensated out-of-  
32          pocket expense to the investors of a utility. Unpredicted  
33          opportunities for economic purchases are different because  
34          incurring their expense is optional. A utility is under no clear  
35          obligation to make the best purchase available if its stockholders  
36          will have to pay part of the purchase expenses. The risk in this  
37          situation is the opportunity cost to ratepayers of the cheapest  
38          purchases not being made. If the best purchase is not made, rates  
39          are higher than necessary. It is this risk we wish to minimize  
40          through the expansion of the fuel adjustment clause regulations.

1   **Q.    WAS THIS LEAST-COST OBJECTIVE MET IN SOUTH CAROLINA?**

2   **A.**    Yes, I believe it was. Up until the mid 1990s, economy power transactions, when  
3           they occurred, were almost always hour-to-hour transactions between  
4           neighboring, vertically-integrated utilities. Many of these transactions were  
5           conducted on the basis of splitting the savings. That is, each utility participating  
6           in the purchase and sale would identify its production cost - a common practice at  
7           that time - and the utility with the lower costs would sell power to the other for its  
8           costs plus one-half of the difference between its costs and the purchasing utility's  
9           avoided cost.

10          Beginning in 1996, the electric power market, facilitated by the FERC NOPR  
11          preceding its Order 888, was undergoing significant change, allowing a much  
12          freer flow of power and the ability to purchase power from an increasing number  
13          of generating sources. The split-the savings methodology became an antiquated  
14          practice. Moreover, the competitive marketplace discouraged the exchange of  
15          production-cost information.

16   **Q.    WAS THERE A LEGISLATIVE RESPONSE IN SOUTH CAROLINA TO**  
17   **THESE CHANGING MARKET CONDITIONS?**

18   **A.**    Yes. In 1996, S.C. Code §58-27-865, which permitted the recovery of all costs of  
19           purchased power, regardless of the purpose for which it was purchased (i.e.  
20           required to meet reliability requirements or for economic reasons) was amended in  
21           an effort to distinguish between the cost of fuel incurred by the Company for its  
22           own generation and the costs for which recovery could be made for purchased  
23           power. (See Exhibit \_\_\_\_ (GCH Rebuttal Ex. 1). In addition to providing for

1 SO2 emission allowances and extending the estimate period from six to twelve  
2 months, the amendment eliminated the authority to recover the total cost of  
3 purchased power and provided only for the recovery of "fuel costs related to  
4 purchased power". For consistency with the FERC policy, the latter provision  
5 was interpreted to mean costs related to a utility's avoided cost determined in  
6 connection with economic purchases of power. For the seven years since this  
7 amendment, this has been the practice of the Company, reviewed by the  
8 Commission staff and approved by this Commission. In fact, following the  
9 enactment of 58-27-865(A), utility representatives met with Commission staff  
10 members to discuss the implementation of this statutory provision. The practice  
11 presently followed by the Company was that agreed upon with the Commission  
12 staff.

13 **Q. IS THE ISSUE BEFORE THE COMMISSION ONE OF RECOVERY OR**  
14 **NONRECOVERY OF THE COSTS OF PURCHASED POWER BEING**  
15 **ADDRESSED IN THIS CASE?**

16 **A.** No party has challenged the prudence or reasonableness of the costs for which  
17 recovery is sought. The only issue raised is the appropriateness of recovery  
18 pursuant to § 58-27-865(A). If not recoverable through the fuel clause, these costs  
19 would only be recoverable in a rate-case proceeding, as was the FERC practice  
20 before 1983, the very practice FERC eliminated by its Order No. 352. The  
21 disincentives about which FERC was concerned would now be resurrected by a  
22 departure from the past practice of this Commission. Moreover, had the Company  
23 known of the policy switch reflected in the \$5,012,249 and \$857,514 adjustment

1 (Report of Audit Department, Audit Ex. G p.5), it, at least, could have estimated  
2 the costs in issue here for inclusion in the test year utilized in its recently-  
3 concluded electric rate case (Docket 2002-223-E).

4 **Q. MS. CHERRY OBSERVES AT PAGE 7 OF HER TESTIMONY THAT**  
5 **TWO OTHER COMPANIES DO NOT RECOVER THROUGH THEIR**  
6 **FUEL CLAUSES WHEELING CHARGES INCURRED IN CONNECTION**  
7 **WITH PURCHASED POWER. WHAT IS YOUR REACTION?**

8 **A.** I am not familiar with the practices of the two companies referred to, however,  
9 these costs are inherent in the cost of purchased power, as discussed by Mr. Klein,  
10 and, I believe, should be recovered through the fuel clause as long as the avoided  
11 cost standard is not exceeded. I point out that the FERC order specifically permits  
12 the recovery of these costs in that manner. Further, as I have already discussed,  
13 the Company has lost its opportunity to estimate and recover these costs in its  
14 recently completed electric rate case.

15 **Q. MS. CHERRY, AT PAGE 7 OF HER PREFILED TESTIMONY, SEEMS**  
16 **TO SAY THAT THE FERC ACCOUNT DENOMINATIONS LENDS**  
17 **SUPPORT TO HER CONCLUSIONS AND RECOMMENDATIONS.**  
18 **PLEASE COMMENT.**

19 **A.** The Company follows the system of accounts required by the FERC. The  
20 denomination of these accounts, however, in meeting FERC's accounting  
21 requirements, does not lead to the conclusion drawn by Ms. Cherry. Indeed, her  
22 conclusion is inconsistent with the practice of the FERC which I have just  
23 discussed. Mr. Klein addresses this issue in some detail.

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes.



# A BILL

TO AMEND SECTION 58-27-865, CODE OF LAWS OF SOUTH CAROLINA, 1976, RELATING TO ELECTRIC UTILITIES AND ELECTRIC COOPERATIVES, RATES AND CHARGES, ESTIMATES OF FUEL COSTS, REPORTS, AND ADJUSTMENT OF DIFFERENCE BETWEEN ACTUAL AND ESTIMATED COSTS, SO AS TO DEFINE "COST" FOR THE PURPOSES OF THIS SECTION, DELETE CERTAIN LANGUAGE, PROVIDE THAT IT MUST BE CONCLUSIVELY PRESUMED THAT AN ELECTRICAL UTILITY MADE EVERY REASONABLE EFFORT TO MINIMIZE COST ASSOCIATED WITH THE OPERATION OF ITS NUCLEAR GENERATION FACILITY OR SYSTEM, AS APPLICABLE, IF THE UTILITY ACHIEVED A NET CAPACITY FACTOR OF NINETY PERCENT OR HIGHER DURING THE PERIOD UNDER REVIEW.

Be it enacted by the General Assembly of the State of South Carolina:

SECTION 1. Section 58-27-865 of the 1976 Code is amended to read:

"Section 58-27-865. (A) The words 'fuel cost' as used in this section shall include the cost of fuel, fuel costs related to purchased power, and the cost of SO<sub>2</sub> emission allowances as used and shall be reduced by the net proceeds of any sales of SO<sub>2</sub> emission allowances by the utility.

(B) The commission shall direct each electrical utility which purchases fuel incurs fuel cost for the generation sale of electricity to submit to the commission, within such time and in such form as the commission may designate, its estimates of fuel costs, including cost of purchased power, for the next six twelve months. The commission may hold a public hearing at any time between the twelve-month reviews to determine whether an increase or decrease in the base rate

2 investigation of the estimate and conducting public hearings in  
3 accordance with law, the commission shall direct each company to  
4 place in effect in its base rate an amount designed to recover, during  
5 the succeeding six twelve months, the fuel costs determined by the  
6 commission to be appropriate for that period, adjusted for the  
7 over-recovery or under-recovery from the preceding six-month  
8 twelve-month period. The commission shall direct the electrical  
9 utilities to send notice to the utility customers with the antecedent  
10 billing of the time and place of the public hearings to be held every  
11 six twelve months, and the commission shall again direct the electrical  
12 utilities to send notice to the utility customers with the next billing if  
13 the utility is granted a rate increase by the commission.

(B)(C) The commission shall direct the electrical utilities to account monthly for the differences between the recovery of fuel costs through base rates and the actual fuel costs experienced, by booking the difference to unbilled revenues with a corresponding deferred debit or credit, the balance of which will be included in the projected fuel cost component of the base rates for the succeeding period. The commission shall direct the electrical utilities to submit monthly reports of fuel costs, and monthly reports of all scheduled and unscheduled outages of generating units with a capacity of one hundred megawatts or greater.

(E)(D) Upon request by the commission staff, the electrical utilities, or the Consumer Advocate, a public hearing must be held by the commission at any time between the six-month twelve-month reviews to determine whether an increase or decrease in the base rate amount designed to recover fuel costs should be granted. If the request is by an electrical utility for a rate increase, the commission shall direct the utility to send notice of the request and hearing to all customers with the next billing, and if the commission grants the rate request subsequent to the request and hearing, the commission shall direct the utility to send notice of the amount of the increase or decrease to all customers with the next billing.

(E)(E) The commission may offset, to the extent considered appropriate, offset the cost of fuel recovered through sales of power pursuant to interconnection agreements with neighboring electrical utilities against fuel costs and purchased power costs to be recovered.

(F)(F) The commission shall disallow recovery of any fuel costs that it finds without just cause to be the result of failure of the utility to make every reasonable effort to minimize fuel costs or any decision of the utility resulting in unreasonable fuel costs, giving due regard to reliability of service, economical generation mix, generating

1 experience of comparable facilities, and minimization of the total cost  
2 of providing service. There shall be a rebuttable presumption that an  
3 electrical utility made every reasonable effort to minimize cost  
4 associated with the operation of its nuclear generation facility or  
5 system, as applicable, if the utility achieved a net capacity factor of  
6 ninety-two and one-half percent or higher during the period under  
7 review. The calculation of the net capacity factor shall exclude  
8 reasonable outage time associated with reasonable refueling,  
9 reasonable maintenance, reasonable repair, and reasonable equipment  
10 replacement outages; the reasonable reduced power generation  
11 experienced by nuclear units as they approach a refueling outage; the  
12 reasonable reduced power generation experienced by nuclear units  
13 associated with bringing a unit back to full power after an outage;  
14 Nuclear Regulatory Commission required testing outages unless due  
15 to the unreasonable acts of the utility; outages found by the  
16 commission not to be within the reasonable control of the utility; and  
17 acts of God. The calculation also shall exclude reasonable reduced  
18 power operations resulting from the demand for electricity being less  
19 than the full power output of the utility's nuclear generation system.  
20 If the net capacity factor is below ninety-two and one-half percent  
21 after reflecting the above specified outage time, then the utility shall  
22 have the burden of demonstrating the reasonableness of its nuclear  
23 operations during the period under review.  
24 ~~(F)(G)~~ The commission is authorized to promulgate, in accordance  
25 with the provisions of this section, all regulations necessary to allow  
26 the recovery by electrical utilities of all their prudently incurred fuel  
27 costs, ~~including the cost of purchased power~~, as precisely and  
28 promptly as possible, in a manner that tends to assure public  
29 confidence and minimize abrupt changes in charges to consumers."  
30

31 SECTION 2. This act takes effect upon approval by the Governor.  
32 ~~XX~~

1 ~~Indicates Matter Stricken~~  
2 ~~Indicates New Matter~~

3  
4 COMMITTEE REPORT  
5 May 8, 1996  
6

H. 4545

7  
8  
9 Introduced by REPS. Klauber, Simrill, Askins, Chamblee, Mason,  
10 R. Smith, Limehouse, Young-Brickell, Koon, Wright, Herdloff,  
11 Sharpe, Knotts, Tripp, Elliott, Fulmer, D. Smith, Gamble, Quinn,  
12 Kennedy, Vaughn, Rice, Cato, Bailey, Wofford, Davenport, Whaley,  
13 Haskins, Worley, J. Young, Littlejohn, Law, Allison, Riser,  
14 Witherspoon, Lanford and Carnell  
15

16 S. Printed 5/8/96-S.

17 Read the first time May 2, 1996.  
18

#### 19 THE COMMITTEE ON JUDICIARY

20 To whom was referred a Bill (H. 4545), to amend Section  
21 58-27-865, Code of Laws of South Carolina, 1976, relating to electric  
22 utilities, etc., respectfully  
23

#### 24 REPORT:

25 That they have duly and carefully considered the same, and  
26 recommend that the same do pass:  
27

28 LARRY A. MARTIN, for Committee.  
29  
30